

**H. R. 664/S. 731 THE PRESCRIPTION DRUG FAIRNESS FOR SENIORS ACT:
INDUSTRY MYTHS VS. REALITY**

**Prepared by the Minority Staff
Committee on Government Reform
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Industry Allegation: The legislation extends price controls to the pharmaceutical industry.

The Facts: The Prescription Drug Fairness for Seniors Act (H.R. 664) does not impose price controls on the pharmaceutical industry. Instead, the legislation ends price discrimination. Under the legislation, companies can set their best price at whatever level they want. The goal of the bill is to allow senior citizens access to prescription drugs at these same low prices.

Since drug companies closely guard their drug prices as trade secrets, the best publicly available indicator of the industry's best prices are the prices that the industry charges the federal government. For this reason, the bill requires the drug companies to make their drugs available to pharmacies for resale to senior citizens at the lowest prices the drug companies charge the federal government.

If a drug company refuses to extend its lowest federal prices to the senior citizen market, the only consequence to the drug company is that the federal government will no longer buy drugs from the company. In this way, the bill uses the buying power of the federal government to end price discrimination and help seniors gain access to the drug companies' lowest prices.

Industry Allegation: The lowest federal prices mandated by the bill are in effect price controls because the prices are set by statute and are lower than the prices that many private-sector buyers must pay.

The Facts: The federal government buys its drugs under a multitude of programs. Some of these programs (such as the Federal Supply Schedule (FSS), the VA Formulary, and the VA Blanket Price Program) determine prices through voluntary negotiations between the federal government and each participating manufacturer. Other programs (such as section 340B of the Public Health Services Act) use statutory discounts. One government program (the Medicaid drug rebate program) explicitly ties the statutory discounts for drugs participating in the Medicaid program to the best private-sector prices, but is prohibited by statute from making this best price information publicly available. Although these programs use different mechanisms for acquiring drugs, their common goal is to obtain prices for the federal government that are as low as those offered to the most favored private-sector purchasers.

It may be true, as the drug companies assert, that some private-sector buyers pay more for their drugs than the federal government. The crucial question, however, is what are the prices that the industry charges its most favored private-sector customers. The pharmaceutical industry has never asserted that these most favored customers must pay more than the federal government. Furthermore, GAO has confirmed that federal supply schedule prices represent the best publicly available information on the prices that pharmaceutical companies charge their most favored customers.¹

¹Letter from William J. Scanlon, Director, GAO Health Financing and Public Health

Industry Allegation: The legislation will force the pharmaceutical industry to reduce research and development expenditures.

The Facts: Historically, there is no evidence to support the industry's claim that preventing pharmaceutical companies from overcharging for their products reduces research. In 1984, Congress passed the Hatch-Waxman Act, which increased the availability of generic drugs and provided more competition for brand name drugs. Before the legislation was enacted, the pharmaceutical industry testified that, "the bill under consideration today could result in a decline in scientific research and innovation."² According to the industry,

The bill's proposed restrictions . . . could have far ranging adverse effects on the development of new technology in this country, including serious implications for the future of university-based research and the emerging and vitally important field of biotechnology research . . . Investment in private pharmaceutical research is likely to decline and will no longer provide the kind of products that have brought such an improvement in public health over the last 30 years.³

However, this legislation did not reduce innovation in the pharmaceutical industry. Indeed, according to industry data, over the next five years pharmaceutical companies more than doubled their investment in research and development, from \$4.1- billion to \$8.4 billion.⁴

Section (April 21, 1999).

²Testimony of Jack Stafford, President, American Home Products, before the Senate Subcommittee on Courts, Civil Liberties, and the Administration of Justice (June 27, 1984).

³ *Id.*

⁴Pharmaceutical Research and Manufacturers of America (PhRMA), *Leading the Way in the Search for Cures* (1998) (www.phrma.org/publications/brochure/leading/index.html).

In 1990, Congress passed legislation that created the Medicaid drug rebate, requiring drug companies to reduce their prices for drugs sold to the Medicaid program. At the time, the Pharmaceutical Manufacturers Association opposed legislation to reduce Medicaid drug prices because “[i]ncentives for pharmaceutical research will be reduced.”⁵ This legislation, however, did not reduce innovation in the pharmaceutical industry. Since 1990, pharmaceutical companies again more than doubled their spending on research and development, from \$8.4 billion in 1990 to \$18.9 billion in 1997.⁶

Industry spokesmen have themselves conceded that the research and development argument is a red herring. According to Jeffrey Trewhitt, a spokesman for the Pharmaceutical Research and Manufacturers of America, competition within the drug industry will keep the industry from reducing research and development: “Basically, companies are going to do whatever they need to do to be able to have the money necessary to spend on research and development, even if it’s \$24 billion a year and still going up.”⁷

Industry Allegation: If the legislation is enacted, the pharmaceutical industry simply will not be able to afford to pay for high levels of research and development.

⁵Testimony of Gerald J. Mossinghoff, President, Pharmaceutical Manufacturers Association, before the House Subcommittee on Health and Environment (September 14, 1990) (attachment to testimony dated May 22, 1990).

⁶*Leading the Way in the Search for Cures*, *supra* note 4.

⁷*Drug Lobby Fights Bill for Senior Citizens*, Portland Press Herald (Feb. 18, 1999).

The Facts: There is no support for the industry's assertion that it could not afford its research and development budget if the legislation were enacted. While the pharmaceutical industry currently spends \$17 billion annually on research and development,⁸ it spends \$11 billion annually on advertising and marketing⁹ and reported \$26.2 billion in profits in 1998.¹⁰ Its operating profit margin is 28.7% -- nearly three times higher than the profit margin of other manufacturers of branded consumer goods.¹¹ Even if the legislation had the effect of reducing industry revenues, the industry could afford to maintain or even increase its spending on research and development.

⁸*Drug Dependency: U.S. Has Developed an Expensive Habit*, Wall Street Journal (Nov. 16, 1998).

⁹*Id.*

¹⁰*1999 Fortune 500 Industry Snapshot: Pharmaceuticals* (1999) (on line at www.pathfinder.com/fortune/fortune500/ind21.html).

¹¹Houlihan Lokey Howard & Zukin, *Expert Analysis of Profitability* (Feb. 1998).

While the industry's research and development expenditures are relatively large as a percentage of revenue, they are not high as a percentage of profit when compared to other large U.S. companies. For example, Ford's expenditures on research and development in 1997 were equal to 90% of its profits, whereas Merck's expenditures on research and development were equal to only 37% of its profits.¹²

This industry assertion of reductions in research also assume a decrease in drug industry revenues **B** an assumption that is not shared by independent analysts in the securities industry. Reducing prescription drug prices will lead to an increase in the volume of sales, as seniors that were previously unable to afford prescription drugs can now afford their medications. According to a recent Merrill Lynch analysis:

Volume increases could overwhelm negative pricing impact. It is important to remember that a reduction in prescription drug prices, both with or without associated prescription benefit coverage, is likely to be associated with price elasticity and increased utilization (especially for Medicare recipients that currently have no drug coverage).¹³

Industry Allegation: The legislation does not guarantee lower prices because pharmacies, not drug companies, are responsible for the high retail markups paid by senior citizens.

The Facts: At the retail level, the pharmacy market is highly competitive: if consumers are unhappy with the prices charged at one retail outlet, they can buy their prescription drugs at a different outlet. This competitiveness guarantees that pharmacies will pass on to senior citizens the benefits of any lower prices for prescription drugs.

According to a leading academic expert, Professor Stephen W. Schondelmeyer, the head of the University of Minnesota's Department of Pharmaceutical Care and Health Systems:

Once a patient is on a given prescription medication, the patient becomes a price competitive consumer. . . . Any discounts passed on to community pharmacies will be passed on to the consumer, or payor, of the prescription because of the competitive retail environment.¹⁴

¹²Annual Report of Ford Motor Co. for the Fiscal Year Ended Dec. 31, 1997; Annual Report of Merck & Co, Inc. for the Fiscal Year Ended Dec. 31, 1997.

¹³Merrill Lynch, *Pharmaceuticals: A Medicare Drug Benefit: May not be so Bad* (June 23, 1999).

¹⁴Schondelmeyer, Stephen W., PRIME Institute, University of Minnesota, *Competition*

The analyses by the minority staff of the Committee on Government Reform demonstrate that the legislation will be effective: lowering prices that pharmacies pay for prescription drugs will lower retail prices for seniors. The study compared the retail markup due to pharmacies with the total markup paid by retail customers. It found that drug companies, not retail pharmacies, were responsible for the significant price differential between the prices paid by retail customers and the prices paid by the drug companies=most favored customers. The analysis found that while the average retail price differential is approximately 100%, pharmacy markups only account for 22% of the price paid by retail customers. This indicates that it is drug company pricing policies, not pharmacies, that are responsible for the high prescription drug prices paid by seniors.

Industry Allegation: The legislation does not address the problems with Medicare. It fails to provide seniors with what they really need: complete coverage for prescription medicines.

and Pricing Issues in the Pharmaceutical Market, University of Minnesota, 12 (August 1994).

The Facts: The ideal solution for seniors would be to enact a Medicare drug benefit -- a solution supported by many members of Congress. Questions have been raised about the price tag of this benefit, however. A comprehensive Medicare drug benefit has been estimated to cost \$20 to \$40 billion annually.¹⁵ In July, the Clinton administration announced a plan to provide prescription drug benefits for all Medicare recipients.

The Prescription Drug Fairness for Seniors Act is an intermediate step that reduces drug prices for seniors without costing the federal government anything. It will measurably improve the quality of life for senior citizens by lowering the price of prescription drugs by approximately 40%. A senior citizen spending \$150 a month on prescription drugs could save over \$700 annually under the legislation.

It is ironic that the pharmaceutical industry criticizes the legislation for failing to provide a comprehensive Medicare drug benefit. Although the drug companies now say that they support the inclusion of prescription drug benefits in private-sector Medicare HMOs, they continue to resist including prescription drug coverage as a universal Medicare benefit. As the New York Times recently reported, drug companies are gearing up to fight any plan for the Government to provide prescription drugs as a basic benefit in the traditional Medicare program.¹⁶ The same companies recently began a multimillion-dollar advertising campaign designed to fight efforts to reduce prescription drug prices for seniors.¹⁷

¹⁵*Medicare Reformers Seek, Once Again, to Implement Drug Benefits for Elderly*, Wall Street Journal (Nov. 17, 1998).

¹⁶*Clinton's Plan to Have Medicare Cover Drugs Means a Big Debate Ahead in Congress*, New York Times (Jan. 23, 1999).

¹⁷Washington Post, *Drugmakers Launch Campaign on Medicare* (July 28, 1999).